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Supreme Court, U.S.
FILED
SEP 10 1996
CLERK

No. 96-102

In the Supreme Court of the United States

OCTOBER TERM, 1995

J. LARRY BRADSHAW, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

WALTER DELLINGER
Acting Solicitor General
LORETTA C. ARGRETT
Assistant Attorney General
BRUCE R. ELLISEN
ALICE L. RONK
Attorneys
Department of Justice
Washington, D.C. 20530
(202) 514-2217

18 pp

QUESTION PRESENTED

Whether the president of a corporation who is responsible for ensuring that taxes withheld from employee wages are paid over to the government may delegate that responsibility to a creditor of the corporation and thereby absolve himself of liability under 26 U.S.C. 6672 for the withheld taxes that were not paid to the government.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A22) is reported at 83 F.3d 1175. The opinion of the district court (Pet. App. B1-B9) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on December 4, 1995. The order denying the petition for rehearing was entered on April 18, 1996 (Pet. App. E1-E7). The petition for a writ of certiorari was filed on July 17, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. During the last quarter of 1985 and the first, second, and third quarters of 1986, petitioner was a

shareholder, director and the president of the Heritage Corporation. He also was a director and the president of its wholly-owned subsidiary, Heritage Building Products (HBP) (Pet. App. A2-A3, B2). On May 10, 1985, petitioner established a line of credit in the amount of $650,000 for HBP with Zions First National Bank. Under the credit agreement, the Bank obtained liens on all of HBP's assets (including accounts receivable) and also obtained the contractual right to freeze the accounts maintained by HBP with the Bank in the event of default. Any funds received by HBP after an event of default were to be deposited into a "control account" and could not be used by HBP without the approval of the Bank (Pet. App. A3, B3).

Approximately one year later, the Bank declared HBP to be in default and elected to exercise its rights under the credit agreement. Beginning on May 29, 1986, HBP was permitted to disburse funds from its accounts only with the prior approval of the Bank. The Bank approved some payments for wages (net of taxes) to petitioner and other employees, to various suppliers and for insurance premiums. The Bank refused, however, to approve payment of the federal and state taxes that had been withheld from employee wages despite petitioner's request that those payments be authorized. In his capacity as president of HBP, petitioner signed the checks that the Bank approved for payment.[1*]

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[1] Petitioner loaned $40,000 to HBP in early 1986. Those funds were used to pay wages owed to employees and interest owed to the Bank. After the Bank seized the company's accounts, petitioner loaned an additional $40,000 to HBP. Those funds were used to pay debts owed to various suppliers and interest owed to the Bank (Pet. App. A4, B7).

In August 1986, HBP entered into an agreement with the Bank under which the company ceased business operations and was voluntarily liquidated. Petitioner signed that agreement on behalf of HBP (Pet. App. A3-A4, B4-B6).

2. HBP failed to pay the government the federal taxes that had been withheld from employee wages for a portion of the fourth quarter of 1985 and for the entire first, second, and third quarters of 1986 (Pet. App. A4, B4-B5, B7). Pursuant to 26 U.S.C. 6672, the Internal Revenue Service made an assessment against petitioner in the amount of the unpaid taxes ($75,601), as a person who was "responsible" for collecting and paying over the withheld taxes who "willfully" failed to do so (Pet. App. A4, B1-B2). Petitioner made a partial payment of that assessment and brought this refund suit in district court. The government counterclaimed for the unpaid balance of the assessment (Pet. App. A4, B2).

After a bench trial, the district court entered judgment in favor of petitioner. The court concluded that petitioner was not "responsible" for paying over the withheld taxes, within the meaning of Section 6672, because he "had no power to disburse any of Heritage's funds without prior approval" by the Bank (Pet. App. B9). The court further concluded that, because the Bank had "complete control of the company's accounts and assets," petitioner had not "willfully" failed to pay over the withheld taxes, as Section 6672 requires (Pet. App. B9).

3. a. The court of appeals reversed (Pet. App. A1-A22). The court held that "a corporate officer may not escape liability as a 'responsible person' under § 6672 by voluntarily entering into agreements which permit preferring other creditors to the government"

(Pet. App. A13). The court concluded that petitioner remained "responsible" for paying over the taxes to the government because his ostensible lack of power to pay the taxes "was the direct result of the Agreement which [petitioner] had negotiated and entered into on behalf of HBP" (*ibid.*). The court explained that "the Bank was able to seize control of HBP's finances only because [petitioner], acting as president of HBP, entered into the Agreement which provided the Bank the opportunity to do so" (*id.* at A18). Because petitioner, acting as president of the corporation, "participated in the arrangement which gave rise to the failure to pay HBP's taxes," he remained "responsible" for those taxes under Section 6672 (Pet. App. A18).

The court further concluded that petitioner had acted "willfully" in failing to ensure payment of the withheld taxes, as Section 6672 further requires (Pet. App. A18-A22). As the court explained (*id.* at E6):

> [Petitioner's] voluntary agreement to cede power over the accounts to the Bank in the even[t] of default, coupled with his knowledge that other creditors were being paid when the IRS was not, is sufficient to make his failure to pay the taxes willful.

b. In reaching these conclusions, the court of appeals stated that it was applying a "*de novo*" standard of review to the determination whether petitioner was "responsible" for accounting for and paying the withheld taxes to the government (Pet. App. A6). The court observed that "the ultimate determination whether an individual is a 'responsible person' within the meaning of 26 U.S.C. §6672 in-

volves an application of law to fact which is subject to *de novo* review on appeal" (Pet. App. A7).

The court further stated that whether petitioner had acted "willfully" (within the meaning of Section 6672) in failing to pay over the withheld taxes is "an issue of fact" for which existing circuit precedent requires a "clearly erroneous" standard of review (Pet. App. A19). The court concluded, however, that the appropriate standard for review of a determination of willfulness under Section 6672 is unimportant in this case because "we conclude that the district court's finding of no willfulness by [petitioner] must be reversed regardless of whether the clearly erroneous or the *de novo* standard of review is applied" (Pet. App. A19).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. a. Under Section 6672(a) of the Internal Revenue Code, a person who is "responsible" for collecting, accounting for and paying over withholding taxes to the government, and who "willfully" fails to do so, is liable for a "penalty" in the amount of the unpaid taxes. 26 U.S.C. 6672(a). The case law has established that an individual is "responsible" under Section 6672 if he has the status, duty, and authority to avoid a default in the collection or payment of the trust fund taxes. *E.g.*, *Thomsen* v. *United States*, 887 F.2d 12, 16 (1st Cir. 1989); *Kinnie* v. *United States*, 994 F.2d 279, 284 (6th Cir. 1993); *Davis* v. *United States*, 961 F.2d 867, 873 (9th Cir. 1992), cert. denied, 506 U.S. 1050 (1993). An officer is "responsible" with-

in the meaning of the statute if he is vested with significant authority over the financial decisions of the corporation (Pet. App. A7-A8):

> [i]ndicia of responsibility include the holding of corporate office, control over financial affairs, the authority to disburse corporate funds, stock ownership, and the ability to hire and fire employees.

Accord, *e.g.*, *Thomsen* v. *United States*, 887 F.2d 12, 16 (1st Cir. 1989); *Kinnie* v. *United States*, 994 F.2d at 283; *Denbo* v. *United States*, 988 F.2d 1029, 1032 (10th Cir. 1993); *George* v. *United States*, 819 F.2d 1008, 1011-1012 (11th Cir. 1987).

A person who is "responsible" for paying over withheld taxes acts "willfully" in failing to do so if he participates in a "voluntary, conscious, and intentional decision to prefer other creditors over the Government." *Denbo* v. *United States*, 988 F.2d at 1033. The requirement of "willfulness" is established if the "responsible" person permits funds of the corporation to be paid to other creditors with knowledge that the taxes have not been paid over to the government. *E.g.*, *United States* v. *McCombs*, 30 F.3d 310, 320 (2d Cir. 1994); *Bowlen* v. *United States*, 956 F.2d 723, 729 (7th Cir. 1992); *Emshwiller* v. *United States*, 565 F.2d 1042, 1045 (8th Cir. 1977); *Davis* v. *United States*, 961 F.2d at 871.

b. Petitioner was the president and a director of HBP. Acting in those capacities, he negotiated financing on behalf of HBP and entered into the credit arrangement with the Bank (Pet. App. A2-A3, A8). He was also the president and a director and shareholder of the Heritage Corporation, which owned all of the stock of HBP (*ibid.*). Petitioner contends that the

control that he granted to the Bank over the finances of HBP absolved him of the responsibility that he otherwise unquestionably had for paying over withheld taxes to the government. The court of appeals correctly held, however, that "a corporate officer may not escape liability as a 'responsible person' under § 6672 by voluntarily entering into agreements which permit preferring other creditors to the government" (Pet. App. A13). Because "the Bank was able to seize control of HBP's finances only because [petitioner], acting as president of HBP, entered into the Agreement which provided the Bank the opportunity to do so," the court concluded that petitioner "participated in the arrangement which gave rise to the failure to pay HBP's taxes" and therefore remained "responsible" for the payment of withheld taxes under Section 6672 (Pet. App. A18). The court further held that, because petitioner paid other creditors during the same period that he knowingly failed to pay withheld taxes to the government, he acted "willfully" within the meaning of the statute (Pet. App. A20-A21).

The holding of the court of appeals—that a "responsible" corporate officer may not absolve his liability under Section 6672 by delegating financial controls to another creditor of the corporation—conforms to well-established precedent. See, *e.g.*, *Commonwealth National Bank* v. *United States*, 665 F.2d 743, 758 (5th Cir. 1982); page 12, *infra*. Indeed, petitioner does not contend that the ruling on the merits in this case conflicts with the decision of any other court. See Pet. 7-9.

2. Instead, without addressing the merits of the decision below, petitioner contends only that the court of appeals applied a standard of appellate review that departs from the standard applied by other courts

of appeals. In particular, petitioner claims (Pet. 7-8) that, in applying a "de novo" standard in reviewing a determination whether a person is "responsible" for paying withheld taxes under Section 6672, the court of appeals departed from the "clearly erroneous" standard that petitioner asserts is applied by other circuits. The conflict in the standard of review that petitioner describes, however, is either nonexistent or insubstantial—it does not exist in substance.

a. In *Taylor* v. *IRS*, 69 F.3d 411 (1995), the Tenth Circuit explained that "factual determinations" are to be reviewed "under the clearly erroneous standard" but that the proper application to such facts of the ultimate statutory standard of liability entails a legal conclusion that must be reviewed "de novo." *Id.* at 415. While findings of basic facts are to be accepted unless "clearly erroneous," "the ultimate determination whether an individual constitutes a 'responsible person' pursuant to § 6672 involves an application of law to fact, which is subject to de novo review" (*ibid.*). The court noted in *Taylor* that at least two other circuits had reached the same conclusion (*ibid.*, citing *Hochstein* v. *United States*, 900 F.2d 543, 547 (2d Cir. 1990); *Thibodeau* v. *United States*, 828 F.2d 1499, 1503 (11th Cir. 1987)). The court further stated in *Taylor*, however, that some other circuits had treated "responsible" person status as an issue of fact, to which a clearly erroneous standard applied (69 F.3d at 415-416, citing *Barnett* v. *IRS*, 988 F.2d 1499, 1504 (5th Cir.), cert denied, 510 U.S. 990 (1993); *Caterino* v. *United States*, 794 F.2d 1, 3 (1st Cir. 1986), cert. denied, 480 U.S. 905 (1987); *Maggy* v. *United States*, 560 F.2d 1372, 1375 (9th Cir. 1977), cert. denied, 439 U.S. 821 (1978)).

Petitioner errs in relying on the description of the case law set forth in the *Taylor* opinion to establish the proposition that a conflict exists among the courts of appeals. The decisions cited by the court of appeals in *Taylor* are all governed by two well-settled, general propositions: (i) that a trial court's findings of fact may be overturned only if they are clearly erroneous but (ii) that the court of appeals is to make a de novo determination of whether the findings of fact satisfy the applicable legal standard and support the trial court's conclusions of law. See *United States* v. *Boyle*, 469 U.S. 241, 249 n.8 (1985). None of the allegedly conflicting decisions departs from these basic principles:

(i) In *Taylor* v. *IRS*, the Tenth Circuit expressly noted that it reviews underlying "factual determinations" only for clear error but conducts a "de novo" review of the "ultimate determination" whether, on the facts thus found, the statutory standard of legal liability for a "responsible" person is met. Accord, *Hochstein* v. *United States*, 900 F.2d at 547; *Thibodeau* v. *United States*, 828 F.2d at 1503.

(ii) In *Barnett* v. *IRS*, the Fifth Circuit explained that, while the existence of "responsible" person status will ordinarily turn on factual determinations, the presence of certain specific facts (such as control over the company and its finances) necessarily establishes that a person is "responsible" as a matter of law. 988 F.2d at 1454. Accord, *Raba* v. *United States*, 977 F.2d 941, 943 (5th Cir. 1992) (describing the "factors" that "determine responsible officer status" such as "holding an office or owning stock in the corporation" and making financial decisions and possessing check-signing authority).

(iii) In *Caterino* v. *United States*, the First Circuit explained that it applies a "clearly erroneous" standard of review for "factual findings" that relate to "the district court's conclusions of responsibility and willfulness." 794 F.2d at 3. The court did not state in *Caterino*, as petitioner implicitly contends, that it would not correct an erroneous application of the legal standards applicable to a determination of responsiblity unless the district court "clearly erred" in its construction of the statute.

(iv) Finally, in *Maggy* v. *United States*, 560 F.2d at 1375, the Ninth Circuit applied a standard of review that is indistinguishable from the review applied by the Tenth Circuit in *Taylor* and in the present case. The court first stated in *Maggy* that "[a] 'responsible person' subject to the reach of 26 U.S.C. §6672 is one who has the final word on which bill should or should not be paid." *Id.* at 1374. Having thus described the applicable legal standard, the court then stated that it would review the trial court's "findings of fact with respect to Maggy's status as a responsible person" for clear error. *Id.* at 1375. On review of the evidentiary record, the court of appeals concluded that the trial court had clearly erred in finding "that Maggy had the final word on what corporate bills were to be paid" (*ibid.*). Because that factual finding was in error, and because (in the court's view) that finding was necessary for Maggy to be "responsible" under the statute, the court of appeals reversed. *Ibid.* Although the decision in *Maggy* contains phrases that can be quoted out of their context for the proposition that a "clearly erroneous" standard of review applies to the ultimate determination of "responsible" person status under Section 6672 (see 560 F.2d at 1375), the appellate review *actually* con-

ducted by the court in that case conforms to the norm—it applies "clearly erroneous" review for findings of fact and "de novo" review to determine whether the findings (that survive clearly erroneous review) support the ultimate legal determination to be made under the statute.

b. The Fifth Circuit—which petitioner contends has adopted the view that "responsible person" status is solely a question of fact (Pet. 8)—has emphasized that courts "cannot ignore the extensive caselaw that narrowly constrains a factfinder's province in § 6672 cases" and that "certain fact patterns will almost invariably prove dispositive of a finding of responsibility." *Barnett* v. *United States*, 988 F.2d at 1454. The other courts on which petitioner relies to establish a conflict with the decision in this case (Pet. 8) have similarly resolved this question as a matter of law when the facts either do not support or instead require the conclusion that "responsible person" status exists. See, *e.g.*, *Thomsen* v. *United States*, 887 F.2d 12, 17 (1st Cir. 1989); *McCray* v. *United States*, 910 F.2d 1289, 1290 (5th Cir. 1990), cert. denied, 499 U.S. 921 (1991); *Morgan* v. *United States*, 937 F.2d 281 (5th Cir. 1991); *Bowen* v. *United States*, 836 F.2d 965 (5th Cir. 1988); *Kinnie* v. *United States*, 994 F.2d 279, 284 (6th Cir. 1993); *Teel* v. *United States*, 529 F.2d 903, 906 (9th Cir. 1976).

As this Court has stated, when a determination of ultimate legal liability entails underlying factual inquiries, "the courts of appeals should not be reluctant to formulate a clear rule of law to deal with" recurring situations. *United States* v. *Boyle*, 469 U.S. at 249 n.8. In the context of the present case, the courts of appeals have uniformly formulated, as "a clear rule of law," the guiding principle that a person who is

"responsible" for paying over withheld taxes cannot escape his liability by delegating his responsibility. *E.g.*, *United States* v. *McCombs*, 30 F.3d at 320; *Kinnie* v. *United States*, 994 F.2d at 284; *Thomsen* v. *United States*, 887 F.2d at 17; *Gustin* v. *United States*, 876 F.2d 485, 491-492 (5th Cir. 1989); *Kizzier* v. *United States*, 598 F.2d 1128, 1132 (8th Cir. 1978); *Purcell* v. *United States*, 1 F.3d 932, 939 (9th Cir. 1993); *George* v. *United States*, 819 F.2d at 1011. The courts have also uniformly agreed that neither a threat of adverse action nor direct instructions from another person can relieve a person who is otherwise "responsible" for the payment of withheld taxes from liability under Section 6672. *E.g.*, *Brounstein* v. *United States*, 979 F.2d 952, 955 (3d Cir. 1992); *Howard* v. *United States*, 711 F.2d 729, 734 (5th Cir. 1983); *Gephart* v. *United States*, 818 F.2d 469, 475 (6th Cir. 1987); *Roth* v. *United States*, 779 F.2d 1567, 1571-1572 (11th Cir. 1986).

In the present case, the court of appeals applied another clear rule of law that correctly deals with a recurring situation. The court held that "a corporate officer may not escape liability as a 'responsible person' under § 6672 by voluntarily entering into agreements which permit preferring other creditors to the government" (Pet. App. A13). That same conclusion has consistently been reached in other circuits. See, *e.g.*, *Commonwealth National Bank of Dallas* v. *United States*, 665 F.2d at 758; *Kalb* v. *United States*, 505 F.2d 506, 510 (2d Cir. 1974), cert. denied, 421 U.S. 979 (1975).[2] Further review is therefore not warranted.

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[2] As the court of appeals observed (Pet. App. A16 & n.6), *Alsheskie* v. *United States*, 31 F.3d 837 (9th Cir. 1994),

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

WALTER DELLINGER
Acting Solicitor General
LORETTA C. ARGRETT
Assistant Attorney General
BRUCE R. ELLISEN
ALICE L. RONK
Attorneys

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involved different circumstances. The corporate officer in *Alsheskie* had no involvement in the original negotiations of the defaulting corporation to obtain the financing agreement that ultimately resulted in the ceding of authority to the lender. 31 F.3d at 838. Indeed, he did not become an officer until after (i) the corporation had defaulted on its financing contract, (ii) the lender took possession of the assets of the corporation pursuant to the security agreement and (iii) a new corporation had been formed to hold the assets of the defaulting corporation. *Ibid.* Unlike petitioner, the officer in *Alsheskie* did not "voluntarily enter[] into agreements which permit preferring other creditors to the government" (Pet. App. A13). The agreements had been entered into by others before he became a corporate officer.